

PS 8563.07 MACHINERY AND EQUIPMENT



Program Statement

OPI: FPI
NUMBER: 8563.07
DATE: 6/13/2001
SUBJECT: Machinery and Equipment

1. **PURPOSE AND SCOPE.** To provide procedures for accounting and control of both capitalized and non-capitalized machinery and equipment maintained at Federal Prison Industries (FPI) field locations and the Central Office.

Machinery and equipment (M&E) includes those tangible items used in or in support of the production process. When an item is 'capitalized,' it is classified as an asset on the balance sheet with the cost allocated against future revenue in a way that attempts to reflect the value received from using that asset.

An item may be capitalized if the acquisition cost and the period of the item's usefulness are significant. Unless otherwise specified, the term 'Machinery and Equipment,' when cited in this Program Statement, refers to capitalized machinery and equipment.

2. **SUMMARY OF CHANGES.** The more significant revisions to this directive are:

- ! Procedures have been modified to reflect FPI's implementation of **Millennium**, its Enterprise Resource Planning (ERP) system;
- ! Procedures have been added for recording and classifying a fixed asset acquired through a capital lease;
- ! Criteria for capitalizing internal use software has been added;

- ! Field locations are now required to maintain a location identifier on the Master Asset record for Machinery within the Plant;
- ! Machinery repairs and rehabilitation costs are now capitalized by charging the costs directly to the asset;
- ! Machinery and Equipment transfers between factories and within a factory have been modified.

3. **PROGRAM OBJECTIVES.** The expected results of this program are:

a. Strict accountability of capitalized machinery and equipment and sensitive equipment will be maintained at all FPI locations.

b. Machinery and equipment will be classified and valued on the financial statements of the Corporation in accordance with generally accepted accounting principles and with the Federal Accounting Standards Advisory Board's (FASAB) Federal Financial Accounting Standards.

4. **DIRECTIVES AFFECTED**

a. **Directives Rescinded**

PS 8563.06	Machinery and Equipment (6/11/99)
OM 056-00 (8563)	Machinery and Equipment (10/10/00)

b. **Directives Referenced**

PS 8562.01	Disposition of Personal Property and FPI Form 30, Report of Survey (1/18/00)
PS 8563.05	Depreciation of Fixed Assets - FPI (3/19/99)
DOJ 2400.3	Justice Property Management Regulations (8/6/98)
SFFAS No 6	Accounting for Property, Plant, and Equipment June 1996
SFFAS No 10	Accounting for Internal Use Software June 1998
41 CFR 101-42 thru 46	

5. **STANDARDS REFERENCED.** None

6. CAPITALIZATION CRITERIA

a. **M&E.** Any M&E acquired that has an initial investment of \$5,000 or more (including transportation and installation less the discount offered) and that has a useful life of five or more years is to be capitalized. Additionally, this M&E must be intended for FPI's use and cannot be intended for sale in the ordinary course of operations.

- ! Such M&E is to be depreciated using a systematic allocation of expenses as outlined in the Program Statement on Depreciation of Fixed Assets - FPI.

- ! Purchases of less than \$5,000 per unit, or items having a life expectancy of less than five years, regardless of unit cost, are to be charged to the appropriate expense.

In some cases, good judgment is required to determine whether an acquisition is to be recorded as M&E, or as Building and Improvements (B&I). Generally, this type of equipment will be classified as M&E if it meets the following criteria:

- ! the equipment is moveable;
- ! its removal will not damage the structure of the building;
- ! the equipment can be used in different centers; and
- ! the equipment is considered to have an independent life.

In most cases, shelving in a warehouse or factory and dust collection systems, are to be classified as M&E.

b. **Donated M&E.** M&E acquired at nominal cost or without exchange of funds, and having an appraised value (as determined by a Board of Survey) of \$10,000 or more, is to be capitalized.

c. **Special Equipment.** Generally, whenever a special tool, die, jig, or other equipment is purchased or manufactured for a special job or contract, that equipment's cost is to be charged to that job.

However, if it is definite that such equipment will be used on future contracts or other production, and the equipment meets FPI capitalization criteria, that equipment is to be capitalized and depreciated over its useful life.

d. **M&E Enhancements.** Machinery repair costs may be either charged to expense or capitalized depending upon the nature of the repair.

- Repairs are considered maintenance expenditures and are charged to expense in the period incurred when they simply preserve the asset's existing service potential.
- A maintenance expenditure neither increases nor decreases the asset's value.
- Low cost, minor repair expenditures are usually required throughout an asset's life to keep it in an efficient operating condition.
- Repairs are considered enhancements and are capitalized when they are material in amount (\$5,000 or more) and they increase significantly the asset's existing service potential by increasing the useful life or the asset's earning capacity.

e. **Idle Equipment.** Equipment that has either been idle or is expected to be idle for a period of 90 days or longer must be classified as idle.

Depreciation must continue on idle equipment unless it has been removed from the M&E account for disposal, retirement, or removal from service. Extended idleness indicates that the equipment may be excess or obsolete, and such equipment is to be evaluated for possible disposal action.

f. **Internal Use Software.** Internal use software is software that is purchased from commercial vendors 'off-the-shelf,' internally developed, or contractor-developed solely to meet internal or operational needs. Software includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to operating a computer system or program.

Internal use software is to be capitalized in accord with Department of Justice guidance as outlined in the Justice Property Management Regulations and related directives. Criteria for capitalization of internal use software is significantly higher than for M&E.

- Internal use software is to be capitalized when the software has an estimated useful life of two years or more; is not intended for sale in the ordinary course

of operations; and is intended to be used or available for FPI's use.

- The dollar threshold for capitalizing internal use software or enhancements to that software is \$500,000 or more.

The FPI Controller may adopt a materiality approach in applying an alternate dollar capitalization threshold **below** the DOJ threshold. In doing so, the FPI Controller must notify the Director, Finance Staff, Justice Management Division in writing, of variances from the \$500,000 threshold. Notification will:

- identify the category of software for which the exception pertains;
- provide clear and concise justification for the threshold variance; and
- identify the fiscal year in which the threshold will be implemented.

g. **M&E Acquired Through a Lease Agreement.** Fixed assets may be acquired under a lease agreement. When this occurs, a determination must be made whether the lease is a simple rental agreement (and the periodic payments charged to expense) or a purchase of a capital asset. A lease is to be considered a purchase of M&E and capitalized when it meets **one or more** of the following four criteria:

- The lease transfers the property's ownership to FPI by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the leased property's estimated economic life.

Note: Lease property's estimated economic life is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the lease's inception, without limitation by the lease term.

- The present value of rental and other minimum lease payments, excluding that portion of the payments

representing executory cost, equals or exceeds 90 percent of the leased property's fair value.

Note: The last two criteria do not apply when the beginning of the lease term falls within the last 25 percent of the leased property's total estimated economic life.

7. **PHYSICAL CONTROL.** The Associate Warden/Superintendent of Industries (AW(I&E)/SOI) must assign responsibility for equipment's care and preservation to an employee who does not have accountability for that equipment's record-keeping. Generally, this individual is the Factory Manager.

The Factory Manager may further delegate responsibility for the equipment to staff equipment custodians within the departments where the equipment is located. The names and titles of these individuals are to be forwarded to the Business Manager, who is then responsible for recording the equipment custodian's name (or position) on each individual master asset record.

a. The equipment's location is to be noted on the master asset record by using a location identifier. The first two digits of this four digit identifier is to contain an alpha character that identifies the institution (i.e., 'as' for Ashland). The last two digits identify a specific area within the Plant and is defined by the Business Manager or his/her designee.

Example:

01 = factory office
02 = factory mill
03 = factory assembly
04 = factory finishing
08 = Quality Assurance
09 = Business Office
10 = Warehouse

A location identifier of as09 identifies an item of equipment assigned to the Ashland Business Office.

- If desired, the physical location may be further defined by using the 'room' field within the Master Data template of **Millenium's** Fixed Assets module.
- Each FPI location must maintain a crosswalk that defines the numeric assigned to each location within the Plant.

b. All accountable property (property noted on the master asset record) must have an accountable equipment custodian. It is this person's responsibility to notify the Business Manager of any change in equipment's status as it occurs (transfer of equipment from one department to another, equipment becomes idle, etc).

8. **ACQUISITION AND RECEIVING.** When any acquired M&E is received, the Business Manager and warehouse personnel have the following responsibilities:

a. The Business Manager is responsible for creating the Assets Shell and obtaining the equipment number from **Millennium** and entering the corresponding sequential tag number into the system.

b. The Business Manager is responsible for creating a Request for Purchase in **Millennium** for M&E and entering the assigned equipment number and corresponding sequential tag number.

c. Upon receiving M&E, warehouse personnel are to check the items against contract specifications for quantity, quality, and condition and notify the purchasing officer of any discrepancies in quantity and/or noticeable quality deficiencies.

d. Warehouse personnel are to complete the receiving transaction for the M&E and verify the equipment's description, and notify the Business Manager that the asset has been received.

e. Warehouse personnel are to identify all M&E by securely attaching the equipment number tag, or otherwise affixing the equipment number to the equipment.

Note: When an equipment item has distinctive and separable components, those components are to be controlled by assigning one equipment number with multiple equipment tag numbers.

f. When notified that the M&E has been received, the Business Manager is responsible for updating the fixed assets shell and entering the serial number, equipment custodian name (or responsible position), and the equipment's location and for verifying that the equipment's description is accurate.

9. **M&E TRANSFERRED FROM ANOTHER LOCATION**

a. When two field locations reach an agreement to transfer M&E, the receiving location must obtain, in writing, approval from both that location's General/Program Manager and the Product

Support Center. The receiving location is to forward a copy of the approval memorandum to the sending location.

b. Upon receiving the approval memorandum mentioned above, the receiving location is to complete an asset shell that references the sending location's equipment number. The receiving location must also create and enter a new equipment tag (that corresponds or cross-references with the new equipment number).

c. Upon receiving the M&E, warehouse personnel must complete a receiving memorandum and forward it to the Business Manager.

d. Upon getting the receiving memorandum, the Business Manager is to complete an asset transfer transaction in the **Millennium** system.

e. The sending institution is to absorb any related shipping costs.

10. **M&E TRANSFERRED WITHIN A LOCATION**

a. The Factory Manager is responsible for notifying the Business Manager of transfers of equipment within the factory that affect cost centers or accountability (i.e., moving a machine to another equipment custodian's area of responsibility).

b. The Cost Center Manager or Branch Manager (i.e., Lexington Customer Service Center, Accounts Receivable, Product Support Center, Central Office) is responsible for notifying the respective Business Manager or Financial Manager of any equipment movements affecting cost centers or accountability.

c. Upon receiving notification of equipment moves, the Business Manager is to update the fixed asset shell for the change, (i.e., department, cost center, equipment custodian).

11. **ACCOUNTING - M&E, OPERATING**

a. Warehouse personnel are to record receiving a fixed asset as a Goods Receipt/Invoice Receipt (GR/IR) transaction, thereby creating a debit to the M&E - Operational account(175100) and a credit to the Accounts Payable - GR/IR account (232100). Care must be taken to ensure that the equipment number in the Assets Shell corresponds to the equipment tag number recorded in **Millennium**.

b. All fixed asset shell records are to be separated into the following seven classifications:

Class	Code Description	Account
1000	Building & Improvements	173000
2000	Machinery & Equipment	175100
2500	Assets Under Capital Lease	181000
3000	Non-capitalized Equipment	N/A
4000	Assets Under Construction	172000
5000	Donated B&I	173000
5100	Donated Machinery & Equipment	175100

c. Idle equipment is to be tagged as "idle," and noted on the Master Assets Record evaluation group.

d. Receipt of donated M&E is to be documented on a Report of Survey after valuation by an AW(I&E)/SOI-appointed Board of Survey. The Business Manager is to establish a fixed assets shell for donated property based upon the Report of Survey's approval.

- Upon receipt of donated property, the accountant is to debit the asset number. The **Millennium** system debits the M&E - Operational account (175100) and credits the Donated Property - Current Year account (322000).
- The donated M&E is to be depreciated in the same way as any other asset.
- The accountant is to recapture the depreciation expenses on the donated M&E via a manual journal entry by debiting the Donated Property - Current Year account (322000) and crediting the Recapture of Donated Property account (713000).

Note: Field locations may need to contact the Financial Manager in FMB in order to affect the 322000 account.

- At fiscal year end, the Corporate Accountant in Central Office is to prepare a manual journal entry transferring the amounts in the Donated Property - Current Year account (322000) to the Donated Property - Prior Years account (322500).
- If FPI subsequently donates the donated M&E to a non-FPI activity, the transaction is to be recorded via a manual journal entry by debiting the appropriate Donated Property account and the Accumulated Depreciation account (175900) and crediting the M&E - Operational account (175100).

- The accountant is to record acquisition of Donated M&E on the Master Assets Record using the class code 5100.

e. Whenever a piece of equipment becomes idle, the employee responsible for that equipment must notify the Business Manager in writing. The Business Manager must ensure that the evaluation group is noted as idle in the Fixed Assets Record.

f. A capitalized asset acquired by a lease, in general, is to be capitalized at the amount represented by the present value of the future lease payments, including any payment called for by a bargain purchase option; the Capital Lease Liability account (294000) is to be credited for this amount.

Executory costs such as maintenance or profit charged are not to be included in the capitalized amount. As periodic payments are made, executory costs and interest are to be charged to expense and the Capital Lease Liability account is debited.

12. ACCOUNTING - MACHINERY REPAIRS AND REHABILITATION COSTS. As noted in Section 6.d. machinery repair costs may be either charged to expense or capitalized depending upon the nature of the repair. Low cost repairs that are required to keep equipment in efficient operating condition are considered a current expense. Normally, the factory maintenance crew will do these repairs. Any inmate labor resulting from these repairs is to be charged to indirect labor.

If the repairs to a piece of equipment are extraordinary (at least \$5,000) and materially prolong the asset's life, the accountant is to capitalize these costs by charging them directly to the equipment number. The Business Manager is to determine the asset's revised useful life in accord with procedures outlined in the Program Statement on Depreciation of Fixed Assets. Then, the accountant will adjust the number of years to depreciate the asset in the Fixed Assets Record.

13. M&E RETIREMENTS. Equipment may be retired by sale, trade, or abandonment. Generally when this occurs, the appropriate M&E account is credited and the corresponding Accumulated Depreciation account is debited.

Any disposal of M&E must be in accord with the requirements and restrictions concerning the use and disposal of fixed assets in 41 CFR 101-42 through 46 and the Program Statement on Disposition of Personal Property and a Report of Survey (FPI Form 30).

When an asset is removed from the M&E account in anticipation of disposal, retirement, or removal from service, depreciation of that asset is to cease.

a. **Sale of M&E.** Any related gain or loss from the sale of M&E is recognized as either a debit or credit to Gain/Losses on Disposition of Assets (721000). The initial entry is performed in **Millennium** using the Scrapping transaction and the Dispose Without Revenue feature.

The Gain/Losses on Disposition of Assets account must be identified with the location's profit center. Documentation is then sent to Centralized Accounts Receivable (CAR) in Lexington KY, where the buyer is to be invoiced for the sales amount of the fixed asset. Upon invoicing the buyer, CAR is to credit the 721000 account identifying it with the field location's profit center.

Example: A machine with a capitalized value of \$18,000 and accumulated depreciation of \$15,000 is sold at auction for \$4,000. The resulting journal entry recording the asset's disposition is as follows:

Accounting for the Transaction recorded at Field Location:

721000	Gain/Loss on Disposition of Asset	3,000	
	(using field location's profit center)		
175900	Accumulated Depreciation, M&E	15,000	
175100	Machinery & Equipment		\$18,000

Accounting for the billing transaction performed at CAR:

131500	Public Billings	4,000	
721000	Gain/Loss on Disposition of Asset		4,000
	(using field location's profit center)		

The CAR must perform the transaction using the field location's profit center.

b. **Trade-In of M&E.** Purchasing a new machine may, on occasion, involve trading in an old machine. When this occurs, a gain or loss is recognized based on the new machine's fair market value. The theory is that the earnings process for the old machine is complete and therefore, a gain or loss has occurred.

Example: A machine with a capitalized value of \$18,000 and accumulated depreciation of \$15,000 is traded on a new machine valued at \$21,000. The vendor gave an allowance of \$1,000 on the old machine. The loss recognized is \$2,000.

Old Machine	\$ 18,000
Less: Accumulated Depreciation	<u>15,000</u>
Net Book Value	3,000
Amount owed to vendor (\$21,000 - 1,000)	<u>20,000</u>
Total Acquisition Cost	23,000
Less: Fair Market Value of New Machine	<u>21,000</u>
Loss on Trade-In	\$ 2,000

The resulting journal entries recording the acquisition and trade-in is as follows:

JOURNAL ENTRY 21

175100	M&E, (New)	\$ 1,000	
175900	Accum Depr, M&E (Old)	15,000	
721000	Losses on Disposition of Assets	2,000	
	175100 Machinery (Old)		\$18,000
175100	M&E (New)	\$20,000	
	232100 Goods Receipt/Invoice Receipt (GR/IR)		\$20,000

The same acquisition, having a trade-in allowance of \$4,000, would incur a gain of \$1,000.

Old Machine	\$ 18,000
Less: Accumulated Depreciation	<u>15,000</u>
Net Book Value	3,000
Amount owed to vendor (\$21,000 - 4,000)	<u>17,000</u>
Total Acquisition Cost	20,000
Less: Fair Market Value of New Machine	<u>21,000</u>
Gain on Trade-In	\$ (1,000)

The resulting journal entries recording the acquisition and trade-in are as follows:

JOURNAL ENTRY 21

175100	M&E, (New)	\$ 4,000	
175900	Accum Depr, M&E (Old)	15,000	
	175100 Machinery (Old)		\$18,000
	721000 Gain on Disposition of Assets		1,000
175100	M&E (New)	\$17,000	
	232100 GR/IR		\$17,000

c. **Abandonment of M&E.** Abandonment of M&E may include machinery that is donated, abandoned, destroyed, or otherwise disposed of at no remuneration to FPI. Then, any remaining book value on the equipment is charged to the Gain/Loss on Disposition of Assets account (721000).

14. **ALLOWANCE FOR OBSOLETE M&E.** On occasion, Central Office may authorize field locations to establish an allowance for obsolete M&E on hand. Requests to establish the allowance must be submitted to the Controller by the location via a Report of Survey.

15. **NON-CAPITALIZED PERSONAL PROPERTY AND SENSITIVE EQUIPMENT.** Any item which has an acquisition cost, donated value, or appraised value of less than \$5,000 is classified as non-capitalized personal property and is charged to expense when received. No accountability records are required for non-capitalized items unless they are classified in one of the following categories:

a. **Tools and Security Items.** Tools and security items that must be controlled within the Correctional Supervisor's office in an institution must be controlled as required by the institution guidelines.

b. **Sensitive Equipment.** These are items commonly found at FPI locations which the AW(I&E)/SOI determines to be highly susceptible to loss or theft, or are considered a security concern.

The items may be either owned or leased. At a minimum, the following items are to be considered sensitive:

VCRs	Radios, two-way
Pagers	Microwave Ovens
Cameras	Facsimile Machines
Camcorders	Body Alarms
Motor Vehicles	Cellular/Mobile Telephones
Dictaphones	Photocopiers
Tape Recorders	Personal Computers
External Modems	

This list is not intended to be all-inclusive. Other items may be added at the AW(I&E)/SOI's discretion.

Although it is not a requirement to include computer peripheral equipment separately (i.e., monitor, keyboard, or printer) on a sensitive equipment list, these items are to be clearly marked as UNICOR equipment.

Note: Sensitive equipment is to be maintained within **Millennium** under asset class 3000.

The FPI Controller may waive the requirement to maintain sensitive equipment in **Millennium**. The AW(I&E)/SOI is to submit a memorandum through his or her respective Field Financial Advisor to the Controller stating the reason why the request is being made and detailing by what means the sensitive equipment will be maintained.

c. **Machinery and Equipment Acquired on Loan.** This category includes equipment loaned to FPI by any source. The warehouse person is to tag the equipment; however, the markings are not to be permanent.

- Physical inventories on such equipment are to be conducted annually, unless the loaning agency requires more frequent inventories.
- The Business Office is to maintain all M&E acquired on loan in **Millennium** under asset class 3000. These items are to be assigned an evaluation group designation of NC (Non-Capitalized Equipment).
- Assignment of responsibility for sensitive equipment and M&E acquired on loan is to be the same as capitalized equipment.
- The Controller must approve any deviations from these requirements in writing.

16. **ANNUAL AND INTERIM PHYSICAL INVENTORIES.** Actual physical counts of M&E are to be taken under the following circumstances.

a. A complete physical inventory of all M&E and sensitive equipment must be taken **annually**.

b. Interim inventories are required whenever an employee responsible for fixed assets in a particular department (equipment custodian) is transferred from that department. The following procedures are to govern the conduct of physical inventories:

- The interim inventory is to be taken of the items for which the departing employee was responsible.
- Whenever possible, the new employee is to conduct the inventory. However, if he or she has not yet arrived, the AW(I&E)/SOI is to designate someone who has no responsibility for the equipment to take the inventory.
- The Business Manager is to provide the employee taking the inventory the list of items that are to be inventoried. The list must contain:
 - P a description of the equipment,
 - P the equipment number,
 - P serial number,
 - P quantity, and
 - P responsible cost center number.
- Any discrepancies discovered are to be reported as outlined in Section 17. Once the inventory is complete and adjustments noted, the new employee is to sign the list containing a statement verifying the list's accuracy and assuming formal accountability.
- A copy of the signed list is to be forwarded to the Business Office where the Master Assets Record is to be updated to reflect the change.
- If the inventory has been taken by someone other than the new employee, that person is to sign the list acknowledging its accuracy.
- Upon assuming his or her duties, the new employee is to be given the list of items for which he or she is responsible and must have an opportunity to inspect the items.

- After that review, the new employee is to sign a statement verifying the list's accuracy and assuming accountability for the items. The signed statement is to be forwarded to the Business Office where the change of custodian is to be made to the Master Assets Record.

17. **PHYSICAL INVENTORIES PROCEDURES.** The AW (I&E)/SOI is to assign an employee(s) to take the required physical inventory of M&E and sensitive equipment. For internal control purposes, employees participating in physical inventories must not be the same individuals who are responsible for such equipment; however, these personnel may assist in locating, identifying and reconciling the physical inventory. Neither are the employees on the inventory team to have responsibility for the record keeping process.

Before actually taking the inventory, Business Office staff are to prepare a list generated from **Millennium** to be given to the person taking the inventory indicating:

- the type of equipment,
- equipment number,
- serial number,
- quantity, and
- responsible cost center.

The employee, accompanied by the individual assigned responsibility for the equipment, must then perform the following:

a. Inspect each item at a location and check off the item on the list as encountered. Items are to be located and cross-referenced to the list. If an item is not on the list, a member of the inventory team is to note:

- the type of machinery/equipment,
- the FPI equipment number,
- the serial number,
- the quantity, and
- the location of the equipment.

At this time an attempt is to be made to locate any items on the list which have not been found. If the item location differs from that on the list, deviations are to be noted. Any other types of discrepancies are also to be listed on the exception list. This step is to be performed at each location where M&E are located.

b. After the fixed assets' physical inspection is complete, the employee(s) must compare the results per the original list of assets and the exception list to the Master Assets Record. All differences are to be noted and incorporated into a written report and forwarded to:

- the AW(I&E)/SOI,
- Factory Manager, and
- Business Manager.

c. The Factory Manager must investigate any discrepancies with the employee assigned the responsibility for the missing fixed assets, and forward a written explanation for all deviations to the AW(I&E)/SOI within two weeks.

d. Upon receiving the Factory Manager's report, the AW(I&E)/SOI must appoint a Board of Survey to:

- review the Factory Manager's response,
- recommend actions to be taken, and
- oversee the implementations of those recommended actions.

e. The AW(I&E)/SOI must forward to the Business Manager the Report of Survey (if applicable), and any supporting documentation along with a written list of the necessary adjustments. Then, the Business Manager or designee is to adjust the Master Assets Record accordingly. Any adjustments must reference the appropriate Report of Survey number.

f. Annual equipment inventories are to be completed using the Physical Inventory List by Cost Center from **Millennium**. A signed copy of the report is to be mailed to the appropriate Field Financial Administrator in FMB and a copy with supporting documentation kept on file at the location for three years or until the next program review, whichever is later.

/s/

Kathleen Hawk Sawyer
Director